No. 7322

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United States

Circuit Court of Appeals

For the Ninth Circuit

LEO. A. MADDEN, Ancillary Receiver of Piggly Wiggly Yuma Company, a corporation,

Appellant,

vs.

MORRIS LaCOFSKE,

Appellee.

Brief of Appellant

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STATEMENT OF THE CASE

Appellant, Leo. A. Madden, on March 14th, 1932, upon his appointment by the United States District Court for the District of Arizona, as Ancillary Receiver of the defendant Piggly-Wiggly Yuma Company, a corporation, took into his possession, as such receiver, a certain grocery business carried on by said defendant in Yuma, Arizona, in a store building located upon land owned by the appellee Morris

LaCofske and leased by him to said defendant, as evidenced by two leases expiring July 1st, 1934, and October 6th, 1934, respectively at a monthly rental of $350.00. (T. R. pp. 8-9-10).

Appellant forthwith entered into possession of said leased premises and of the stock of merchandise and store fixtures contained therein belonging to said defendant and continuously conducted thereon the said grocery business until the 16th day of November, 1932, (T. R. p. 13), when the same was delivered over to one Herman J. Schwartz who paid appellant therefor the sum of $2250.00. (T. R. p. 20). Appellant paid appellee the full amount of rent stipulated in said leases, to-wit, $350.00 per month, covering the entire time of his occupancy of said leased premises. (T. R. p. 20).

On November 22nd, 1932, appellant, without notice, petitioned said court for an order authorizing the sale to said Herman J. Schwartz of said fixtures and stock of merchandise and the assignment to him of said leasehold interest in said premises for the sum of $2250.00, (T. R. p. 1-6), and on November 23rd, 1932, an order was entered herein authorizing such sale and assignment at private sale without notice, the same to be final, and that said sale and assignment were consummated. (T. R. p. 7).

Thereafter on November 30th, 1932, appellant notified appellee of said sale and assignment and that future demands for rent be made upon said Herman J. Schwartz. (T. R. p. 20).

On May 2nd, 1932, appellee filed with appellant his claim against the estate of defendant corpora-

tion, in which he demanded, among other things, rent for the full unexpired terms of said leases based upon the landlords' lien laws of the State of Arizona (par. 3671 Rev. St. Ariz. 1913 and par. 1958 Rev. Code Ariz. 1928.) (T. R. pp. 13-17).

On March 9th, 1933, appellee filed his petition herein (T. R. pp. 8-26) setting forth substantially the foregoing facts and further, without alleging fraud or collusion or knowledge on the part of appellant, averring that on December 3rd and 4th, 1932, the said Herman J. Schwartz, without the knowledge and consent of appellee, "moved out all the merchandise and much of the movable fixtures used in connection with said grocery business conducted in said leased premises aforesaid and the whereabouts of said merchandise and fixtures is unknown to your claimant," (T. R. p. 21) and praying the court to require appellant to pay forthwith rent accruing since November 15th, 1932, and a further sum estimated as the cost of restoring the leased premises to its original condition as covenanted in the lease, and to impress the funds realized from said sale in the hands of appellant with a lien for the payment thereof. (T. R. p. 26).

Appellant stipulated that the facts set forth in said petition were true and correct, and the issues were submitted to the court for determination of the questions of law raised thereby. (T. R. pp. 27-28).

Thereafter the court entered judgment, inter alia, that appellant "did not relieve himself of the liability to pay the rent to the landlord provided for in said leases by an assignment of said leases;" (T. R. p. 39), that appellee recover of and from appel-

lant $2975.00, being rent accruing from November 15th, 1932, to July, 1933; (T. R. pp. 39-40), that such judgment is a first lien on the amount realized by appellant from the sale of said merchandise and fixtures; (T. R. p. 40), that payment be made out of said moneys and the balance out of any other moneys coming into the hands of appellant; (T. R. p. 40), that appellee recover nothing from appellant as and for restoration of the leased premises; (T. R. p. 40), that as to liability for rent not yet accrued the court reserves that question to be determined in the light of future conditions. (T. R. p. 40).

ASSIGNMENT OF ERRORS

Appellant's Assignment of Errors set forth in the Transcript of Record (pp. 42-44) may be embraced within two assignments of fundamental error, which if found to be well taken, will sustain the collateral assignments, viz:

I.

The lower court erred in its conclusion of law that the appellant as receiver of the defendant corporation, Piggly-Wiggly Yuma Company, did not relieve himself of the duty and obligation to pay the rent to the landlord provided for in the leases described in said decree by assigning said leases, and in rendering judgment in accordance therewith against appellant in the sum of $2975.00 or in any sum. (T. R. pp. 39-40).

II.

The lower court erred in its conclusion of law that the appellee, landlord, is entitled to a first lien upon

the funds realized and received by appellant, receiver, from the sale of the merchandise and fixtures in said leased premises and in rendering judgment in accordance therewith impressing a lien upon such funds for the payment of its judgment for rent in the sum of $2975.00 in favor of the appellee. (T. R. p. 40).

PROPOSITIONS OF LAW

The appellant submits the following propositions of law upon which the foregoing assignments are predicated:

I.

A receiver who adopts a lease of property held by the insolvent and continues to occupy the same, becomes by operation of law an assignee of the term and is obligated to the landlord by privity of estate only to perform covenants of the lease running with the land during such time as he holds under the lease, and he may relieve himself of such obligation at any time by assigning the lease to a third person and delivering possession of the leasehold.

II.

One having a lien upon property in the hands of a receiver or other fiduciary which is sold by order of court, must look to the property alone for payment, and, in the absence of fraud or other circumstances justifying the application of equitable principles, cannot claim payment out of the proceeds of the sale unless such property be ordered sold free from such lien.

ARGUMENT AND CITATION OF AUTHORTIES

First Assignment:

It is to be noted that there was no express assignment of the lease from the defendant corporation to the receiver, nor did the receiver at any time expressly agree to become bound by the covenants of the lease. Whatever obligation arose therefore was created by operation of law as a result of the receiver taking possession of the leasehold and adopting the lease.

A comprehensive summary of the question of the liability of receivers as assignees of leases is found in Tiffany, on Landlord and Tenant, Vol. 1, beginning at page 987, an excerpt of which is quoted below:

> "The question of the liability of a receiver, as an assignee of the leasehold, upon the covenants of the lease, including that for rent, would seem, primarily, to depend on the question whether the title to property of that character is vested in the receiver by his appointment. Whether a receiver, by his appointment, obtains title to the property of which he is given control, is a matter on which the decisions are by no means in accord, but it seems that, by the weight of authority, a receiver is, apart from statute, to be regarded as a mere custodian and representative of the court, and not as having title to the property. So regarded, it does not appear that a receiver appointed for a tenant should, unless an assignment were actually made to him by the tenant, be held liable on the covenants of the lease as an assignee, and there are cases to that effect. The courts have, however, more usually regarded the receiver as lia-

ble on such covenants, as being an assignee by operation of law, (citing numerous cases, including Link Belt Mach. Co. v. Hughes, 174 Ill. 155, 55 N.E. 179; DeWolf v. Royal Trust Co., 173 Ill. 435; 50 N. E. 1049; Woodruff v. Erie R. Co., 93 N. Y. 609; Frank v. New York L. E. & W. R. Co., 122 N. Y., 197, 25 N. E. 332; Wells v. Higgins, 132 N. Y. 459, 30 N. E. 861), provided he has indicated an intention to accept the leasehold as a part of the assets of the insolvent tenant, but not otherwise, thus applying the same rule as is applied in the case of a trustee in bankruptcy and, by the American decisions, of an assignee for creditors. The cases are generally to the effect that the assumption of physical possession and control of the leased premises by the receiver does not show an acceptance by him of the leasehold interest, so as to impose liability on him as an assignee of the leasehold, but that he may retain possession for a 'reasonable time' and then give up the property if this seems expedient. But it is generally held or assumed that, apart from any question of the acceptance of the leasehold, the landlord is entitled to payment of rent, for the period of the receiver's occupation for the purpose of settling the estate, as one of the expenses of the receivership, at least to the extent of the earnings or the rental value of the property * * * * * * * * * Conceding that the receiver becomes liable for rent by retaining possession, he can terminate that liability by assigning over to some 'man of straw'."

The question of the liability of the assignee of a leasehold generally, is discussed in Tiffany on Landlord and Tenant, Vol. 1, pp. 987, et seq., as follows:

"The liability of the assignee of the leasehold on the covenants entered into by the lessee, though based primarily on 'privity of con-

tract,' as existing only by reason of such covenants, is also, in a sense, based on privity of estate, as being imposed on him by reasons of his ownership of the leasehold. Consequently, such liability endures only so long as this privity continues, and it comes to an end when the privity is ended by the assignment of the leasehold interest of the assignee to another, a 'reassignment' by him, as it is frequently expressed. (Citing numerous cases, including Consolidated Coal Co. v. Peers, 166 Ill. 361, 46 N. E. 1105; McKeon v. Wendelken, 55 N. Y. Supp. 626; and Mason v. Smith, 131 Mass. 510).

"The effect thus given to a reassignment by the assignee is not changed by the fact that it is made for the purpose of freeing him from liability, or that it is made with knowledge on his part that his assignee is entirely insolvent, a mere beggar in fact, or is otherwise unable to perform the covenants of the lease. (Citing Johnson v. Sherman, 15 Cal. 287). * * * * * * * * * In order that the reassignment of the leasehold may relieve the assignee from liability, it is not necessary that the landlord be notified of the reassignment, or that he consent thereto, (citing Tibballs v. Iffland, 10 Wash. 451, 39 Pac. 102), and it has been held that the reassignment is effective for the purpose though it is in violation of a covenant of the lease not to assign without license, this according with the general rule that an assignment in violation of such a covenant is valid."

In the case of U. S. Trust Co. v. Wabash R. Co., 150 U. S. 287, 14 Sup. Ct. 86, 37 L. Ed. 1058, it was held that where a receiver elects to adopt a lease, a privity of *estate* is thereby created between him and the lessor, by which he becomes liable upon the covenant to pay the rent. This we have shown is the

general rule. A privity of *contract* is not created, however, between the receiver and the lessor. In Northwestern Mut. Life Ins. Co. v. Security Savings & Tr. Co., 261 Fed. 575, (U.S.C.C.A. Or. 1919), the liability of the assignee of a lease is recognized to be by privity of estate, and obligates him to perform covenants that run with the land.

The liability of the receiver in this connection would be, therefore, tantamount to that of an assignee of the lease. The leading authority in the state of Arizona, wherein the leased premises are located, is the case of McKee's Cash Store v. Otero, 171 Pac. 910, 19 Ariz. 418, which case was decided in 1918 and has never been overruled. In that case, the court quotes the following excerpts from Washburn on Real Property:

> "Such assignee, therefore, is not liable for any breach committed before he became assignee, nor for any such breach occurring after he has parted with the estate and possession to a new assignee, although he did this for the very purpose of escaping such liability, because by so doing he destroys the privity of estate on which it depends."

The court goes on to state the manner in which the assignee of the lease may escape liability, as follows:

> "If the McKee's Cash Store, as assignee, wished its liability to pay rent to continue only during its actual possession of the premises, it should have reassigned the lease as well as abandoned the possession. By so doing the privity of estate would have terminated."

In the instant case, the receiver did exactly this. The great weight of authority is in support of this proposition. In 35 C. J., p. 998, and cases found in the notes thereunder, the general rule is stated to be:

> "An assignment of the lease by the assignee thereof terminates his liabilities so far as they rest upon privity of estate, equity following the law in this respect. The rule applies, although the lessee has convenanted for himself and assigns not to assign without the lessor's consent, or although the assignment is for the purpose of avoiding the obligations of the lease or to an irresponsible party, but the assignment must be actual and valid, and have been accepted by the assignee. Notice to the landlord is not essential."

In conclusion, it appears that the lower court did not hold the appellant on the theory of privity of contract, for the reason he was held not liable on the covenant to restore the premises. (T. R. p. 40). The court necessarily, therefore, must have predicated his liability on the theory of privity of estate, which liability has been shown to have terminated.

Second Assignment:

The theory upon which the appellee asked the court to impress a lien upon the funds in the hands of the receiver realized from the sale of the merchandise and fixtures, and upon which the court entered its judgment impressing such lien thereon, was not that the appellee was entitled to invoke the equitable powers of the court to relieve him against fraudulent or inequitable conduct on the part of the receiver resulting in the destruction of the lien upon the property, nor that the receiver had sold

it free from his lien; but solely that the receiver by adopting the lease had obligated himself for the payment of the rent for the full term thereof regardless of whether or not he continued in possession of the leasehold. There was no showing of fraud or other inequitable conduct on the part of the receiver, neither was there any showing that the applee had lost his lien upon the property by reason of anything the receiver had done in the premises, such as selling free from the landlord's lien, or permitting removal of the property; and the judgment of the lower court in impressing a lien upon the proceeds in the hands of the receiver could only have been entered as a result of the conclusion reached by the court that the receiver had obligated himself for the payment of the rent for the full term of the lease. In so doing, the court lost sight entirely of the fact that the sale was made subject to the landlord's lien, that the property passed to the purchaser burdened with the lien, and that the landlord was thereby placed in no worse situation than he was in when the receiver took possession. Therefore, there was no basis upon which a court of equity could impress a lien upon the proceeds of the sale. If the receiver was obligated to pay the rent for the full term of the lease, as the lower court held, it was because he was bound thereto through privity of contract, and that obligation he could, of course, discharge by applying thereto any funds in his hands belonging to the estate, including proceeds from the sale, and, indeed, the court recognized this by ordering him to pay any surplus over and above such proceeds out of any other moneys coming into his hands (T. R. p. 40). Consequently, it was unnec-

essary, even in the view of the situation taken by the court, to impress a lien upon such funds.

Appellee may argue that the circumstances of the case entitle him to a lien upon the funds regardless of the basis upon which the court decreed it. We submit that such circumstances do not show appellee to be so entitled. It is true that in 36 Corpus Juris 503, par. 1483, under the title of Landlord and Tenant, may be found the following: "But if the property of the tenant is taken into the custody of the law and converted into money, the lien will attach to such proceeds." Five cases are cited as supporting the text. An examination of these cases discloses that in each of them the property was sold under circumstances cutting off and destroying the lien upon the property itself. We take this to mean, therefore, that where the entire property in the goods is sold, as distinguished from the equity therein above existing liens, the liens, thereby being cut off from the goods, are transferred to the proceeds.

The universal rule seems to be that when property in custodia legis is sold subject to existing liens, such liens cannot be transferred to the proceeds of the sale, and the reason for the rule seems obvious: if only the equity is sold less money is realized than if the entire property were sold, and to require the lien to be discharged therefrom is to enrich the purchaser at the expense of the estate.

> "The general rule is that the purchaser takes the property subject to whatever liens and encumbrances existed thereon at the time of the attaching of the lien under which the property is sold, and cannot have the proceeds of

the sale applied to discharge such liens." 35 C. J., p. 78, par. 121, under the title Judicial Sales. Also see Roberts v. Hughes, 81 Ill. 130, 25 Am. R. 270; Branham v. Long, 6 KyL 451; Sansbury v. Belt, 53 Md. 324; Vaughn v. Clark, 5 Nebr. 238; Coal v. Higgins, 23 N. J. Eq. 308; In re McKenzey, 3 Pa. 156; Bennett v. Booth, 70 W. Va. 264, 266, 73 SE 909, 39 LRANS 618.

This rule is recognized in bankruptcy proceedings.

"Where the property is sold subject to encumbrances, one having a lien on such property must look to the property alone for payment and cannot claim payment out of the proceeds of the sale." 7 C. J. 241, par. 377, under the title Bankruptcy. In re Gerry, 112 Fed. 957.

In Hayes v. Armstrong, 145 Md. 268, 125 Atl. 610, it was held that where land was sold by receivers under the court's order subject to complainant's mechanic's lien, complainant was not entitled to share in the proceeds.

The sale in this case was made in pursuance of an order of the court (T. R. p. 7) which did not authorize a sale free from existing liens, and in the absence of such authorization, was made subject thereto, this being particularly true because of the inclusion in the sale of the leasehold interest of the insolvent.

"In some jurisdictions the rule formerly prevailing that the court could not order a sale of property by the receiver free from encumbrances has been changed by statute . . . Where the authority given by statute is not exercised and the order to sell is general without mention of prior liens or encumbrances, a sale there-

under conveys the property and franchises subject to the lien of prior encumbrances." 14a Corpus Juris 1008, par. 3257, under the title Corporations. Hackensack Water Company vs. DeKay. 36 N. J. Eq. 548.

"As in other judicial sales, the general rule is that the purchaser takes the property subject to whatever liens and encumbrances exist against the property at the time the receiver was appointed, whether the property is sold expressly subject to encumbrances or is sold without mention of liens and encumbrances." 53 C. J. 224, par. 375, under the title Receivers. Also see Home Trust Co. v. Miller Petroleum Co., 27 F. (2d) 748; Weil v. Zacher, 92 Ill. A. 296; State v. Skinner, 81 Ind. A. 1, 142 NE 387; Hayes v. Armstrong, 145 Md. 268, 125 A 610; Federal Trust Co. v. Bristol County St. R. Co., 222 Mass. 35, 109 NE 880; Cashin v. Alamac Hotel Co., 98 N. J. Eq. 432, 131 A 117; Hackensack Water Co. v. De Kay, 36 N. J. Eq. 548; Matter of Coleman, 174 N. Y. 373, 66 NE 983; Edinburg Irr. Co. v. Paschen, (Commn. A.) 235 SW 1088; Houston, etc., R. Co. v. Ennis, (Civ. A.) 201 SW 256 (Certiorari den 252 U. S. 583 mem, 40 SCt 393 mem, 64 L. ed 728 mem, writ of error dism 256 U. S. 684 mem, 41 SCt 622 mem, 65 L. ed. 1171 mem).

"A receiver is not a bona fide holder; therefore, a purchaser at receiver's sale cannot be a bona fide purchaser, because he takes only the rights of the receiver, who in turn takes only the rights of the insolvent." Stram v. Jackson 248 Mich. 171, 226 N. W. 888, 892.

"Existing liens and encumbrances being in no way affected by the appointment of a receiver of the property subject thereto, the receiver ordinarily has no power to sell property free

> from such encumbrances, and the court having charge of the receivership ordinarily has no power to authorize or direct such a sale by the receiver except as power so to do may be conferred upon the court by statute. But when the court has jurisdiction of the property and of all the parties concerned and a sale of the property becomes expedient in the interests of all the parties, the court has power to order a sale free from such encumbrances, the lien thereof being transferred to the proceeds of the sale . . Such power should not be exercised, however, unless there is a reasonable prospect that the property will bring such a price as to leave a surplus over the secured debt for general creditors." 53 C. J. 209-210, par. 328, under the title Receivers. Seaboard Natl. Bank v. Rogers Milk Products Co. 21 Fed. (2nd) 414.

It becomes quite apparent, therefore, that the lower court, in entering its order authorizing the receiver to sell the encumbered property, did not intend that it be sold free from encumbrances. The receiver, in petitioning for the order of sale represented to the court "that the amount of rent to accrue under said leases far exceeds the value of said fixtures and stock of merchandise," (T. R. p. 4), and to have sold it free of the landlord's lien, transferring such lien to the proceeds, would have been an idle and useless procedure so far as any benefit to the general creditors is concerned.

The receiver had elected to treat the leasehold interest as an asset. He later determined it was to the best interest of the creditors and stockholders to dispose of the store. (T. R. p. 3). The purchaser was buying the store. (T. R. p. 6). This included the stock of merchandise, fixtures, and the leasehold

interest. There was no removal or segregation of the merchandise and fixtures by the receiver from the store, and there is no showing that he authorized the purchaser to remove the same from the premises.

In conclusion, we wish to observe that there is not the slightest suggestion in the record of any bad faith or misconduct on the part of the receiver throughout the entire transaction, and the lower court, under the facts before it, clearly did not, and could not hold him upon such a theory.

We respectfully submit, therefore, that the two assignments of fundamental error herein discussed, are well taken, and that the decree of the lower court should be reversed and set aside, and the petition of the appellee dismissed with costs to the appellant.

Respectfully submitted,

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